



BEFORE THE ARIZONA CORPORATION

KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF
UNS ELECTRIC, INC. FOR THE
ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES
DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE OF
THE PROPERTIES OF UNS ELECTRIC, INC.
DEVOTED TO ITS OPERATIONS
THROUGHOUT THE STATE OF ARIZONA.

Arizona Corporation Commission

APR -2 2010

DOCKETED BY

OF UNS ELECTRIC, INC.

April 2, 2010

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1 UNS Electric ("UNS Electric" or "Company"), through undersigned counsel, submits its
2 Reply Brief in support of its requested relief in Docket No. E-04204A-09-0206. UNS Electric
3 believes its request is reasonable, appropriate and supported by the evidence as *explained* below:

4 **I. INTRODUCTION.**

5 It is undisputed that UNS Electric has invested approximately \$86 million in plant between
6 June 30, 2006 and December 31, 2008 to provide its customers safe and reliable service. It is also
7 undisputed that UNS Electric is not currently recovering or earning a return on any of that
8 investment. It is undisputed that UNS Electric still faces tight debt and credit markets where access
9 to capital is restricted. In light of these facts, it is important that UNS Electric maintain its
10 financial integrity and that it have sufficient revenue to meet the needs of its customers *and* attract
11 capital at reasonable cost and on reasonable terms. Based upon the evidence in this case, UNS
12 Electric's requested rate increase of approximately \$13.5 million is just, reasonable and in the
13 public interest.

14 As fully explained in its Initial Post-Hearing Brief, UNS Electric took affirmative steps to
15 minimize the amount of its requested rate increase. Further, the net effect of its requested rate
16 increase together with the adjustments in the Company's Purchased Power and Fuel Adjustment
17 Clause ("PPFAC") results in most customers experiencing an *decrease* in the total amount on their
18 bills from the date UNS Electric filed its rate application (April 30, 2009) to when the Company
19 anticipates new rates are likely to be in effect (on or around June 1, 2010).

20 The evidence entirely supports the Company's request to acquire Black Mountain
21 Generating Station ("BMGS") as well as the necessary rate reclassification in order to afford such
22 acquisition. BMGS is a facility that will provide UNS Electric with significant financial and
23 operational benefits it simply cannot get anywhere else. As evidenced in the record, the Company
24 cannot finance the acquisition absent the rate reclassification it requests in this case without
25 serious adverse consequences to its financial integrity. Finally, the revenue-neutral rate
26 reclassification will not result in any change in the overall price paid for electric service by
27 ratepayers on the date of the reclassification. In short, the risk of approving this request is *de*

1 *minimus*, but the benefits are numerous in size and scope.

2 This Reply Brief emphasizes and summarizes the evidence that supports the Company's
3 rate request. UNS Electric also responds to the arguments from Staff and RUCO, and why their
4 respective recommendations would likely damage the Company's financial integrity. The
5 Company has met its burden to establish that its rate request is just and reasonable and supported
6 by the evidence through the testimony of its witnesses and exhibits. Therefore, UNS Electric's
7 rate request should be granted.

8 **II. BLACK MOUNTAIN GENERATING STATION.**

9 UNS Electric has always understood that its proposed acquisition of BMGS is not a typical
10 request. The facts and circumstances, however, justify the rate base treatment and rate
11 reclassification UNS Electric seeks in this case. Unlike in the prior UNS Electric rate case, the cost
12 of BMGS is known and the facility is in commercial operation. The rate base adjustment will be a
13 fixed, known and measurable amount of \$62 million – which is its original cost net depreciation.¹
14 At the date BMGS is put into rate base, the Company will institute a revenue-neutral rate
15 reclassification – increasing its non-fuel base rates by a set amount per kWh and decreasing its
16 base power supply charge by the same amount.²

17 RUCO, which opposed UNS Electric's request to rate base BMGS in its last rate case,
18 supports the Company's request here. RUCO's support corroborates UNS Electric's position that
19 acquiring BMGS is beneficial to ratepayers and in the public interest. RUCO noted throughout
20 this case that the cost of BMGS is now known and the plant is in operation (as opposed to the
21 Company's last case).³ RUCO also understands that the requested revenue-neutral rate
22 reclassification is fundamental to UNS Electric being able to finance the acquisition.⁴ The
23 Company appreciates RUCO's support and its recognition of the substantial benefits obtained
24 through the Company's BMGS proposal.

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26 ¹ Ex. UNSE-12 (Grant Direct) at 8.

27 ² See Ex. UNSE-12 (Grant Direct) at 11-12; UNSE-18 (Erdwurm Direct) at 27-28;

³ See e.g. Tr. (Johnson) at 590. See also RUCO's Initial Closing Brief (March 23, 2010) at 5.

⁴ Ex. RUCO-6 (Johnson Direct) at 18-21.

1 **A. The evidence is undisputed that UNS Electric acquiring BMGS provides**
2 **numerous and substantial benefits to the Company and its Customers.**

3 The evidence is indisputable that BMGS provides abundant operational and financial
4 benefits. If placed into rate base, BMGS will save ratepayers money through the cumulative
5 benefits of both depreciation expense and deferred income taxes. These benefits consequently
6 reduce the Company's revenue requirement for owned generation capacity versus a long-term
7 purchase power or lease agreement.⁵ Ownership of BMGS also lessens the need to post margin or
8 collateral posting requirements.⁶ Further, improved cash flow from BMGS will improve UNS
9 Electric's creditworthiness, provide additional funding of capital expenditures and allow the
10 Company to attract financing on more reasonable terms.⁷

11 The operational benefits -- including full operational flexibility, full control over
12 maintenance and operation, having in-house generation to exactly meet peak capacity and reserve
13 needs, and having generation at a location that minimizes transmission costs -- are all undisputed.
14 No party disputed that ownership of BMGS would improve the reliability of UNS Electric's
15 system including intermittency issues, which would also enhance the ability to develop renewable
16 energy in Mohave County.⁸ Additionally, BMGS would significantly improve and diversify UNS
17 Electric's power portfolio and no party can deny the benefits of achieving such diversity.

18 **B. Staff's Arguments against Rate-Basing BMGS are Unfounded.**

19 Staff does not challenge the many benefits BMGS will provide to UNS Electric and its
20 customers if the Company is permitted to rate base the facility. Staff does not dispute that the
21 Company's rate reclassification proposal will be revenue neutral on the date of the reclassification.
22 Rather, Staff makes several arguments that are simply not supported by the evidence in the record.

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26 ⁵ Ex. UNSE-12 (Grant Direct) at 5-6.

27 ⁶ Ex. UNSE-12 (Grant Direct) at 6-7.

⁷ Ex. UNSE-13 (Grant Rebuttal) at 18.

⁸ Ex. UNSE-8 (McKenna Direct) at 19-20.

1 **1. Ownership of BMGS is not a dispositive factor.**

2 First, Staff argues that because UNS Electric does not own BMGS, it should not be placed
3 into rate base.⁹ This is not the first occasion, however, that a facility not owned by a utility would
4 be placed into rate base. The Commission approved a settlement agreement and authorized the
5 rate-basing of generation assets to Arizona Public Service Company ("APS") then-owned by an
6 affiliate of APS.¹⁰ The Commission found that rate-basing those generation assets was in the
7 public interest.¹¹ Staff supported the rate-basing of those assets as a signatory to that settlement
8 agreement.¹² Therefore, ownership of assets by a utility is not a prerequisite to including BMGS in
9 rate base upon acquisition by UNS Electric.

10 **2. All material facts about BMGS are known.**

11 Second, Staff argues that all the facts about BMGS are not known.¹³ But Staff never states
12 what facts are not known about BMGS or why those so-called unknowns are material to the issue
13 of whether to approve UNS Electric's request. To the contrary, all the material facts are known
14 about BMGS – including its original cost and its operations.¹⁴ Further, Staff witness Dr. Fish
15 admitted to the numerous financial and operation benefits of acquiring BMGS as being known and
16 tangible benefits to the Company.¹⁵ RUCO's witness Dr. Ben Johnson testified that "adding
17 BMGS to rate base in this proceeding will not harm, and could possibly improve, the Company's
18 credit metrics – something that is in the long term best interests of customers."¹⁶ Staff's argument
19 about the so-called unknowns about BMGS lacks merit.

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24 ⁹ See Staff's Opening Br. (March 23, 2010) at 5.

25 ¹⁰ See Decision No. 67744 (April 12, 2005) at 12.

26 ¹¹ See Decision No. 67744 at 12.

27 ¹² Decision No. 67744 at 6-7.

¹³ Staff's Opening Br. at 5.

¹⁴ See Ex. UNSE-8 (McKenna Direct) at 13-14; Ex. UNSE-12 (Grant Direct) at 8; Tr. (McKenna) at 103-04.

¹⁵ Tr. (Fish) at 445-46, 448, 480-81.

¹⁶ Ex. RUCO-6 (Johnson Direct) at 20.

1 **3. BMGS is a reliable facility.**

2 Third, Staff attempts to imply that BMGS is somehow unreliable -- stating that "at the time
3 of hearing, one of the units was not functional due to some mechanical failure."¹⁷ The evidence,
4 however, is undisputed that the plant would be back in full commercial operations by mid-
5 February 2010 at no cost to UNS Electric, because it was under warranty.¹⁸ And far from being a
6 plant "with uncertain operational reliability" as Staff tries to imply,¹⁹ Staff's technical and
7 operational expert witness W. Michael Lewis testified that BMGS was well-constructed and that
8 the plant is used and useful from his perspective.²⁰ He further testified that BMGS was properly
9 constructed and that both units "have been available (with the exception of the recent problem
10 with Unit #1) and have provided generation to the UNS Electric grid since June 2008 . . . "²¹ The
11 evidence on the record does not support Staff's implications on this point.

12 **4. BMGS is both used and useful, and a prudent investment.**

13 Fourth, Staff argues that a prudence review was not feasible and it could not make a used
14 and useful determination.²² These arguments are unfounded. Staff's witnesses had every
15 opportunity to tour and visit the facility. In fact, Staff's witness Mr. Lewis did visit the facility.²³
16 Contrary to Staff's assertion, it had every opportunity to conduct full and complete discovery in
17 this case about BMGS. Further, Staff issued numerous data requests about BMGS and the
18 Company responded to those requests. RUCO's witness, Dr. Ben Johnson, testified that he knows
19 of no allegation of imprudence, and believes that BMGS would be cost-effective over the life cycle
20 of the plant.²⁴

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22 ¹⁷ Staff's Opening Br. at 7.

23 ¹⁸ Tr. (McKenna) at 102; Ex. UNSE-8 (McKenna Rebuttal) at 5.

24 ¹⁹ See Staff's Opening Br. at 7.

25 ²⁰ Ex. S-7 (Lewis Direct) at 26; Tr. (Lewis) at 418, 423.

26 ²¹ Ex. S-7 (Lewis Direct) at 26.

27 ²² Staff's Opening Br. at 6-7. Staff attempts to use Mr. Lewis' testimony during the evidentiary hearing to justify this argument. See Staff Opening Br. at FN43. But Staff's reliance is misplaced. In fact, Mr. Lewis stated "Okay. The statement about the reliability was aimed at the distribution system and doesn't include anything to do with the Black Mountain as Black Mountain is not, my understanding, is not owned by UNSE and, therefore not part of their system per se." See Tr. at 413.

²³ Ex. S-7 (Lewis Direct) at 25.

²⁴ See Ex. RUCO-6 (Johnson Direct) at 19.

1 “Original cost rate base” is defined as “an amount consisting of the depreciated original
2 cost, prudently invested, of the property (exclusive of contributions and/or advances in aid of
3 construction) at the end of the test year, used *or* useful, plus a proper allowance for working capital
4 and including all applicable pro forma adjustments.”²⁵ Investments are “prudent” if, under
5 ordinary circumstances, they would be deemed reasonable and not dishonest or obviously
6 wasteful.²⁶ The evidence clearly shows that BMGS is being used – currently through a purchase
7 power agreement (“PPA”). The record reflects that placing BMGS in rate base would allow
8 UNSE and its customers to realize greater benefits through the ownership of BMGS. The record
9 also establishes that the purchase price of BMGS is very reasonable as the turbines used at BMGS
10 were acquired at a significant discount. RUCO recognizes this fact and has argued that there is
11 “no question that ratepayers would be getting the benefit of a good deal should the Company make
12 the acquisition.”²⁷ Therefore, the Commission should approve the Company’s proposed
13 acquisition of BMGS.

14 **5. BMGS operation and maintenance expense is known and measurable.**

15 Fifth, Staff argues that the Company “did not demonstrate that the operation and
16 maintenance costs were fully known and certain during this proceeding.”²⁸ In fact, the Company’s
17 proposal includes a known and measurable adjustment for BMGS operation and maintenance
18 expense of \$1,158,464.²⁹ Again, that adjustment would result in no net change in the price paid by
19 customers for electric service on the date of the rate reclassification.³⁰ RUCO agrees that the
20 Company’s adjustment for BMGS operations and maintenance expense is known and
21 measurable.³¹ Staff’s argument is counter to the evidence in this case, and should be rejected.

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25 ²⁵ See A.A.C. R14-2-103.A.3.h.

26 ²⁶ See A.A.C. R14-2-103.A.3.i.

27 ²⁷ RUCO’s Initial Br. at 7.

28 ²⁸ Staff’s Opening Br. at 7.

29 ²⁹ See Company Final Schedules (March 1, 2010) at BMGS C-2; Ex. UNSE-15 (Dukes Direct) at 31.

30 ³⁰ Ex. UNSE-12 (Grant Direct) at 3.

31 ³¹ See RUCO Final Schedules (March 1, 2010) at BJ-7, page 3.

1 **6. UNS Electric cannot finance the acquisition of BMGS without**
2 **significant adverse consequences if the Commission denies its request in**
3 **this case.**

4 Sixth, Staff argues that “despite the Commission’s favorable treatment of the Company’s
5 proposed purchase of the BMGS, the Company chose not to purchase the BMGS.”³² The facts are
6 not that simple. UNS Electric appreciates the Commission approving UNS Electric’s financing
7 authority in its last rate case, but, as evidenced in the record, this was insufficient to allow it to
8 finance the acquisition. Further, the Commission’s approval of an accounting allowing deferral of
9 BMGS-related costs did not provide the cash flow necessary to finance the facility.³³ UNS
10 Electric’s witness Kentton C. Grant explained that acquiring BMGS without the proposed rate
11 reclassification would mean that the Company would incur almost \$5 million of cash expenses
12 without any additional revenues.³⁴ Such an acquisition is imprudent and infeasible. RUCO agrees
13 that “it would not have been prudent for the Company to attempt to finance the plant since its last
14 rate case.”³⁵ The evidence clearly shows UNS Electric lacked the capability to acquire BMGS –
15 even if it had the authority to do so.³⁶

16 The evidence further shows that: (i) seeking an opinion from Moody’s on the this issue
17 would have been neither practical nor prudent;³⁷ (ii) seeking rate base treatment in a subsequent
18 rate case would mean UNS Electric facing a 18-to-24 month lag in rate recognition;³⁸ (iii) UNS
19 Electric would fact the daunting task of financing an acquisition equivalent to 32% of its total
20 capitalization;³⁹ and (iv) it is likely that UNS Electric’s investment-grade rating would be eroded
21 and it would incur higher interest rates absent rate base treatment for BMGS in this case.⁴⁰ UNS

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23 ³² Staff’s Opening Br. at 5-6.

24 ³³ Tr. (Grant) at 159-62, 237.

25 ³⁴ Ex. UNSE-12 (Grant Direct) at Ex. KCG-2; Tr. (Grant) at 233-34.

26 ³⁵ RUCO Initial Closing Brief at 5.

27 ³⁶ Ex. UNSE-13 (Grant Rebuttal) at 5.

³⁷ Tr. (Johnson) at 589.

³⁸ Tr. (Grant) at 236; see also Ex. RUCO-6 (Johnson Direct) at 19 (noting a “potentially serious problem”
 with regulatory lag and the large size of the investment relative to the Company’s “small current
 capitalization”).

³⁹ Ex. UNSE-12 (Grant Direct) at 9, 11.

⁴⁰ Tr. (Grant) at 237.

1 Electric would have to wait years to receive recognition of BMGS in rates absent its request for
2 rate base treatment and rate reclassification.⁴¹

3 Moreover, although Staff points to UED's ownership of BMGS as some sort of proof that
4 UNS Electric could have financed ownership of BMGS itself,⁴² Staff does not address the fact that
5 UED does not face the significant regulatory lag that UNS Electric faces and UED could begin to
6 recover on its investment immediately.⁴³

7 Finally, the evidence shows that neither of the so-called "interim" financing methods
8 suggested by Staff witness David C. Parcell are viable alternatives to the Company's proposal.⁴⁴
9 As RUCO notes in its brief, to receive an equity infusion would have meant UNS Electric's parent
10 goes without any cash return for an indeterminate amount of time.⁴⁵ Contrary to Staff's position,
11 the evidence is clear that, absent approval of the Company's proposed rate base treatment, it could
12 not acquire BMGS without serious adverse consequences to its financial integrity.⁴⁶ It is therefore
13 not accurate to state that the Company simply chose not to acquire the facility after its last rate
14 case.

15 **C. Conclusion: UNS Electric's proposal to acquire BMGS is in the public**
16 **interest.**

17 The Company met its burden to justify its proposal for rate base treatment of BMGS and
18 the accompanying revenue-neutral rate reclassification. In recognition of this, RUCO supports the
19 Company's proposal. Staff fails to present any evidence that challenges the credibility of the
20 Company's expert witness testimony or exhibits. Further, should its proposal be approved, UNS
21 Electric will take any and all steps to acquire BMGS and obtain approval from the Federal Energy
22 Regulatory Commission ("FERC"). It will notify Staff upon completion of the purchase regarding
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25 ⁴¹ Tr. (Grant) at 236.

26 ⁴² Staff's Opening Br. at 6.

27 ⁴³ Tr. (Grant) at 236.

⁴⁴ See UNS Electric Initial Post-Hearing Br. (March 23, 2010) at 16.

⁴⁵ See RUCO Initial Closing Brief at 6.

⁴⁶ Tr. (Fish) at 155-59.

1 the transfer of ownership and rate reclassification.⁴⁷ For all the reasons stated here, in evidence
2 and as summarized in its Initial Post-Hearing Brief as well as here, the Commission should
3 approve the Company's request.

4 **III. RATE BASE.**

5 **A. Post-Test-Year Plant.**

6 **1. Response to Staff.**

7 In UNS Electric's last rate order (Decision No. 70360), the Commission denied UNS
8 Electric's request for post-test-year plant, noting that UNS Electric made no attempt to limit its
9 request to revenue-neutral plant. UNS Electric accepted the criticism and addressed it in this case
10 by limiting its request to non-revenue producing plant. While Decision No. 70360 did not provide
11 specific direction on precisely how to establish plant as appropriate for post-test-year plant, UNS
12 Electric relied on past Commission orders in justifying its request. UNS Electric also supported its
13 request through its testimony and exhibits. In short, contrary to Staff's position, the Company
14 provided ample evidence to support its request.

15 UNS Electric's request includes only those investments made during the test year for plant
16 that will be in service by the time this rate case is concluded.⁴⁸ The purpose of this plant is clear
17 and undisputed. It is necessary to preserve system reliability by avoiding system interruptions and
18 failures.⁴⁹ This is plant that is needed to ensure the delivery of safe and reliable electricity
19 regardless of customer growth.⁵⁰ Also, neither Staff nor RUCO presented any evidence that the
20 plant in question had any material impact on expenses. Because the evidence shows that the plant
21 is necessary and there will be no material impact on revenues or expenses, the Company's request
22 to include post-test-year plant should be approved.

23 Further, past Commission orders have approved inclusion of post-test-year plant under
24 similar circumstances. That is, UNS Electric tailored its request so that it was in accordance with
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26 ⁴⁷ Ex. UNSE-12 (Grant Direct) at 12.

27 ⁴⁸ Ex. UNSE-16 (Dukes Rebuttal) at 9-10.

⁴⁹ Ex. UNSE-16 (Dukes Rebuttal) at 10.

⁵⁰ Ex. UNSE-16 (Dukes Rebuttal) at 10.

1 these past Commission decisions that approved post-test-year plant. The Company limited its
2 request to only that plant that is non-revenue-producing, which will be in service by the time this
3 rate case is concluded, and where the investment occurred during the test year.⁵¹ In addition, the
4 Commission has approved post-test-year plant without any showing of “extraordinary
5 circumstances.”⁵² Further there are no requirements stated in any of those orders that requested
6 post-test-year plant be: (i) a certain percentage of total rate base; (ii) only included when the utility
7 is in serious financial straits; or (iii) is only allowed for larger projects.⁵³ The Commission
8 approved post-test-year plant for Chaparral City Water Company in October 2009.⁵⁴ Finally, the
9 Commission recently granted APS post-test-year plant for 18 months after the end of its test year.⁵⁵

10 Here, UNS Electric proposes inclusion for the similar reasons and under similar
11 circumstances as many of the water and wastewater companies that were permitted to include post-
12 test-year plant.⁵⁶ A \$7,263,614 investment is a sizable investment for a company like UNS
13 Electric. The evidence is clear and undisputed that UNS Electric has not earned its authorized
14 ROE – even after current rates became effective.⁵⁷ This is in large part due to regulatory lag. The
15 Company simply requests that it be permitted to recover costs for post-test-year plant in a timely
16 manner, rather than waiting over three years to start recovering on its investment.⁵⁸ Based on the
17 record, the Commission should approve the Company’s request to rate base post-test-year plant
18 that serves existing customers and that will be in service by the time this case is decided.

19 2. Response to RUCO.

20 RUCO’s argument against including post-test-year plant appears to be mainly that “it is
21 good public policy to continue to base rates of the historical test year and not on post test year
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23 ⁵¹ Ex. UNSE-16 (Duke Rebuttal) at 9.

24 ⁵² See Decision No. 65350 (November 1, 2002) at 11; Decision No. 67279 (October 5, 2004) at 6.

25 ⁵³ See Ex. UNSE-27 (Staff Response to UNSE 3.5 and 3.6).

26 ⁵⁴ See Decision No. 71308 (October 21, 2009).

27 ⁵⁵ Decision No. 71448 (December 30, 2009), attached Settlement Agreement at 12, Section 3.4; but see
Dissenting Opinion of Commissioner Pierce at 1.

⁵⁶ Ex. UNSE-17 (Dukes Rebuttal) at 13.

⁵⁷ Ex. UNSE-12 (Grant Direct) at 17-18; Ex. UNSE-13 (Grant Rebuttal) at 22.

⁵⁸ Ex. UNSE-17 (Dukes Rebuttal) at 10.

1 investments that will hopefully be completed and in use at the time new rates go into effect.”⁵⁹
2 This is in addition to the essentially the same arguments Staff made regarding this item. RUCO’s
3 witness Dr. Johnson argued that the Commission should strictly adhere to the historical test year.
4 But this is contrary to Commission regulations, past Commission practice and RUCO’s position in
5 this case. First, as stated in the Company’s Initial Post-Hearing Brief, “Commission rules and
6 regulations allow for pro forma adjustments to ‘obtain a normal or more realistic relationship
7 between revenues, expenses and rate base’”⁶⁰ Second, the Commission has in almost every single
8 rate case made pro forma adjustments when justified – including to add post-test-year plant in
9 certain cases. Third, RUCO advocates for a pro forma adjustment in other areas in this case such
10 as property taxes. In short, RUCO advocates for an extreme position that is not supported by the
11 record.

12 **B. BMGS Working Capital.**

13 The only other rate base issue involved an adjustment for BMGS Working Capital.
14 Because Staff opposes UNS Electric’s rate base treatment for BMGS, it did not make this
15 adjustment. RUCO does not oppose the adjustment. The Commission should approve this
16 adjustment as part of the Company’s request to include BMGS in rate base.

17 **IV. OPERATING EXPENSES.**

18 **A. Call Center Expense.**

19 Staff’s position is that, because of reduced service calls, Call Center expense should be
20 reduced. Nevertheless, Staff admits: (i) handling service calls is just one of the purposes for the
21 Call Center;⁶¹ and (ii) that it would not be prudent for UNS Electric to contract the Call Center in
22 case the number of calls increases.⁶² Further, the Call Center has reduced duration times because
23 of measures including the virtual hold program.⁶³ Staff does not dispute that \$880,553 is the
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26 ⁵⁹ RUCO’s Initial Closing Br. at 9.

27 ⁶⁰ UNS Electric Initial Post-Hearing Br. at 18.

⁶¹ Tr. (Fish) at 472-73.

⁶² Tr. (Fish) at 474-75.

⁶³ Ex. UNSE-8 (McKenna Direct) at 8.

1 actual amount the Company incurred during the test year. The evidence justifies UNS Electric's
2 Call Center test-year expense as reasonable; therefore, the Commission should adopt that amount.

3 **B. Outside Legal Expense.**

4 The Company proposes an outside legal expense amount that is based on a method
5 previously approved by the Commission. Although RUCO and Staff agree that normalizing
6 outside legal expense is appropriate, both parties propose different normalization methods. The
7 Company believes these other normalization methods do not accurately reflect what the
8 Company's on-going expense will be going forward. Therefore, the Company maintains that its
9 proposed amount is reasonable and in conformance with how the Commission has determined this
10 expense in past cases.⁶⁴

11 **C. Fleet Fuel Expense.**

12 The Company's fleet fuel adjustment of (\$56,333) reflects average fuel and cost data from
13 2007 through September 2009 – as it stated in its Initial Post-Hearing Brief.⁶⁵ By contrast, Staff
14 advocates for an adjustment of (\$75,798) based on AAA-forecasted statewide prices that include
15 urban areas not in UNS Electric's service territory.⁶⁶ It is undisputed that fuel prices in urban areas
16 are lower than in rural areas. Therefore, Staff's adjustment does not accurately reflect the costs
17 that UNS Electric will incur in its more rural service territory. The Commission should reject
18 Staff's adjustment and adopt the Company's adjustment.

19 **D. Rate Case Expense.**

20 In its last rate case, UNS Electric argued against a rate case expense of only \$300,000 as
21 not reflecting the actual costs it incurred in responding to the abundant discovery requests from the
22 parties preparing pre-filed testimony, participating in the evidentiary hearing and preparing two
23 closing briefs incorporating every single issue in the rate case. Here, the uncontroverted evidence
24 is that the Company incurred \$436,000 of expense for preparing pre-filed testimony and
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27 ⁶⁴ See UNS Electric Initial Post-Hearing Br. at 25-26.

⁶⁵ See UNS Electric Initial Post-Hearing Br. at 21.

⁶⁶ Ex. UNSE 16 (Dukes Rebuttal) at 31; Tr. (Fish) at 476-77.

1 responding to discovery.⁶⁷ The Company's request for \$500,000 would not even reflect all of the
2 actual costs it will incur to process this rate case.⁶⁸

3 Staff and RUCO recommendations are clearly unrealistic and ignore the undisputed
4 evidence. It is troubling that both parties seemingly advocate denial of costs related directly to
5 responding to the abundant data requests. Relying on past orders (especially when both parties
6 deviate from past orders for other expenses) and ignoring the evidence does not justify keeping
7 rate case expense at an unrealistic level. The Company's request is reasonable, realistic and
8 supported by the evidence.

9 **E. Payroll Expense and Payroll Tax Expense.**

10 RUCO opposes the Company's adjustment for 2010 because it believes that adjustment
11 strays too far from the historic test year. RUCO continues to ignore the fact that this case will not
12 be concluded until well into the 2010 calendar year. Payroll increases for 2010 will be in effect.
13 The Company only requests adjustments to payroll to employee levels as of the end of the test
14 year.⁶⁹ UNS Electric's Payroll and Payroll Tax adjustments are reasonable, reflect the Company's
15 known payroll costs when new rates go into effect, and are consistent with past Commission
16 orders on this issue.

17 **F. Bad Debt Expense.**

18 The Company, in its Initial Post-Hearing Brief, describes why its bad debt expense is
19 reasonable and should be included in rates.⁷⁰ The Company's method smoothes the volatility in
20 bad debt expense and is consistent with what the Commission has approved in several past rate
21 cases. Staff fails to present any evidence that the Company's method is not a reasonable way to
22 calculate Bad Debt expense. The Commission should therefore adopt the Company's method in
23 this case.

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26 ⁶⁷ Ex. UNSE-16 (Dukes Rebuttal) at 22.

27 ⁶⁸ Ex. UNSE-17 (Dukes Rejoinder) at 5.

⁶⁹ Ex. UNSE-16 (Dukes Rebuttal) at 14.

⁷⁰ See UNS Electric Initial Post-Hearing Br. at 26-27.

1 **G. Incentive Compensation and Stock-Based Compensation.**

2 Both Staff and RUCO argue that only 50% of the Company's Performance Enhancement
3 Program ("PEP") expense should be allowed in rates, relying primarily on the prior rate orders for
4 UNS Electric, UNS Gas and Southwest Gas Corporation. UNS Electric does not dispute that those
5 recent Commission decisions have allowed UNS Electric to recover 50% of PEP expense.
6 However, neither those past decisions nor Staff or RUCO address Decision No. 69663 (June 28,
7 2007), where the Commission approved full recovery of cash-based incentive compensation
8 expense for Arizona Public Service Company ("APS") for a program very similar to the PEP.
9 UNS Electric did discuss that decision, however.⁷¹ That decision supports full recovery of UNS
10 Electric's PEP expense.

11 Moreover, as set forth in detail in UNS Electric's Initial Post-Hearing Brief, no party in this
12 case disputes the benefits and importance of incentive-based compensation and do not contest the
13 reasonableness of the overall compensation paid.⁷² The Commission is required "to allow a
14 recovery for all reasonable expenses." *Tucson Electric Power Co. v. Ariz. Corp. Comm'n*, 132
15 Ariz. 240, 245, 645 P.2d 231, 236 (1982). The undisputed record here shows the PEP is a
16 reasonable expense. Therefore, the Commission should allow full recovery of the PEP expense.

17 RUCO also challenges the Company's stock-based compensation, relying on the prior UNS
18 Electric rate order. But like incentive compensation, RUCO cannot dispute the reasonableness of
19 the expense or that it is tied to the long-term incentives; so UNS Electric should allow it full
20 recovery of its stock-based compensation expense.

21 **H. Supplemental Executive Retirement Plan ("SERP").**

22 Both Staff and RUCO oppose any recovery for the Company's SERP expense. Neither
23 Staff nor RUCO assert that the expense is improper, unreasonable in the industry or unreasonable.
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27 ⁷¹ See Ex. UNSE-16 (Dukes Rebuttal) at 16.

⁷² UNSE Initial Post-Hearing Br. at 26-28.

1 In fact, the evidence is that SERP expense is typical.⁷³ Staff and RUCO's recommendations are
2 beholden to limitations from the Internal Revenue Code.⁷⁴

3 Because the Company proposes to recover the amount of expense required to keep
4 retirement benefits equal as a percentage of compensation for eligible employees, UNS Electric is
5 entitled to recovery that reasonable expense.

6 **I. Wholesale Credit Support.**

7 The Company, in its Rebuttal filing, accepted as an alternative Staff's recommendation to
8 recover such support in base rates, as opposed to through the PPFAC. Consequently, the
9 Company proposed an adjustment of \$195,500 based on taking the weekly average balance of
10 wholesale credit support (from August 10, 2008 through April 21, 2009) and multiplying that
11 figure by 1.15%.⁷⁵ The Company explained the basis for using these figures, and Staff did not
12 dispute the reasonableness of the amount of these costs. Staff also did not dispute that these costs
13 are necessary part of procuring fuel and purchased power.

14 Contrary to Staff's implication, the Company did not include these costs as part of the cost
15 of debt.⁷⁶ Only the costs related to UNS Electric's long-term debt (and perhaps some revolving
16 credit facility commitment costs) were included in the Company's weighted cost of debt.⁷⁷ Short-
17 term borrowing was not included in the Company's original rate request. If these costs are not to
18 be recovered through the Company's PPFAC, then it is reasonable and appropriate to recover a
19 normalized level of expense through base rates.

20 **J. Income Tax.**

21 As explained in UNS Gas' Initial Brief, synchronizing interest expense with rate base is the
22 methodology that has been used by the Commission for over 30 years. Both RUCO and the
23 Company agree that it is the appropriate method to be used in this case. In his Direct Testimony,
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⁷³ Ex. UNSE-16 (Dukes Rebuttal) at 20.

26 ⁷⁴ Ex. UNSE-16 (Dukes Rebuttal) at 21.

27 ⁷⁵ Ex. UNSE-13 (Grant Rebuttal) at 28.

⁷⁶ Tr. (Grant) at 202-03.

⁷⁷ Tr. (Grant) at 203.

1 Dr. Fish also used interest synchronization. However, in a schedule attached to his Surrebuttal
2 Testimony, Dr. Fish suddenly deviates from his initial recommendation. Dr. Fish made this
3 adjustment without providing any explanation or justification for using a different method.

4 Dr. Fish's revised approach is simply wrong and produces an inaccurate adjustment.
5 During the hearing, Dr. Fish conceded that his method for income tax expense could include
6 interest related to items not in rate base.⁷⁸ Dr. Fish acknowledged that interest synchronization is
7 standard practice in Arizona.⁷⁹ In its initial brief, Staff does not attempt to explain or justify Dr.
8 Fish's deviation from established Commission precedent; rather Staff simply reports the amount of
9 its proposed interest expense adjustment.⁸⁰

10 The evidence supports synchronizing interest as part of the income tax expense
11 determination in accordance with decades of Commission practice and because it results in an
12 accurate Income Tax expense amount.

13 **V. RETURN ON EQUITY.**

14 UNS Electric showed throughout this case (as detailed in its Initial Post-Hearing Brief)
15 that: (i) it is smaller than any of the comparable companies used by the respective cost of capital
16 witnesses in this case; (ii) that its bond rating is less than the comparable companies; (iii) it does
17 not pay a dividend.⁸¹ These undisputed facts show that UNS Electric is a riskier investment than
18 the comparable companies in the respective sample groups. It is simply illogical to come to any
19 other conclusion.

20 Despite its increased risk, Staff and RUCO recommend ROEs significantly below the
21 Company's recommendation. The Company addressed the flaws in both the Staff and RUCO
22 methodologies of ascertaining their respective ROEs extensively in its Initial Post-Hearing Brief.⁸²
23 To adopt either of the ROE recommendations that Staff and RUCO advocate is to believe that
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25 ⁷⁸ Tr. (Fish) at 461.

26 ⁷⁹ Tr. (Fish) at 460.

27 ⁸⁰ Staff Opening Brief at 16.

⁸¹ See UNS Electric's Initial Post-Hearing Br. at 35-36.

⁸² UNS Electric Initial Post-Hearing Br. at 38-41.

1 UNS Electric is 100 to 175 basis points less risky than APS (who was recently awarded an ROE of
2 11.0%).⁸³

3 Although some have implied the ROE for UNS Electric should be lowered because of the
4 current state of the economy, UNS Electric must compete with other utilities and entities in tight
5 debt and equity markets. The recommendations of Staff and RUCO would negatively impact UNS
6 Electric's ability to acquire additional capital, much less capital on attractive terms. Such
7 arguments also fail to acknowledge that the inputs to the cost of capital models already reflect the
8 current state of the economy.⁸⁴

9 **A. Response to Staff.**

10 Staff witness David C. Parcell relies on a single-stage discounted cash flow ("DCF")
11 analysis. But investors do not expect a single uniform growth rate. This is why UNS Electric
12 witness Martha Pritz relied on the multi-stage DCF analysis. Indeed, the Commission has relied
13 on the multi-stage DCF analysis in addition to the single-stage DCF analysis in several decisions
14 cited in the Company's Initial Post-Hearing Brief.⁸⁵ The Commission should, at least, rely on both
15 methods here.

16 Further, many of the inputs Mr. Parcell uses in his DCF analysis are fundamentally flawed.
17 Mr. Parcell relies on exclusively historical data for two of his growth rates, when investors have
18 taken historical data into account when developing forward-looking estimates.⁸⁶ Mr. Parcell's
19 retention growth figures are unreasonably low, yet he assumes those figures would continue in
20 perpetuity. Mr. Parcell's comparable earnings analysis assumes that the only result is to keep
21 market to book ratio above 1.0 when three of the four average actual market to book ratios are
22 above 1.5.⁸⁷ UNS Electric must compete in the real world with other electric utilities having
23 market to book ratios well above 1.0. Plus Mr. Parcell assumes the Company will earn an ROE of
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26 ⁸³ See Decision No. 71448 at 8-9, 55.

27 ⁸⁴ Tr. (Pritz) at 694.

⁸⁵ UNS Electric Initial Post-Hearing Br. at 42.

⁸⁶ Ex. UNSE-23 (Pritz Rebuttal) at 2-3.

⁸⁷ Ex. UNSE-23 (Pritz Rebuttal) at 6.

1 10.0% when the evidence reflects that will not be the case. In fact, UNS Electric will earn less than
2 what Mr. Parcell indicates the comparable earnings analysis shows for comparable electric
3 utilities.⁸⁸

4 Finally, Staff's recommended ROE here (10.0%) is 100 basis points below what Mr.
5 Parcell recommended for APS (11.0%).⁸⁹ In other words, to accept Staff's recommendation
6 means one believes UNS Electric is that much less risky than APS. Given that APS is larger and
7 pays a dividend, this is not a reasonable belief.

8 **B. Response to RUCO.**

9 Like Staff, RUCO relies on use of only the single-stage DCF model. To make matters
10 worse, RUCO witness William A. Rigsby assumes that utilities' market-to-book ratios will move
11 toward 1.0 when the evidence shows that this is clearly not the case.⁹⁰ By contrast, Ms. Pritz relies
12 on independent analyst forecasts from Value Line, and data compilations from Zacks Investment
13 Research and SNL Financial for her near-term growth rates.⁹¹ By doing so, Ms. Pritz avoids bias
14 in her analysis while using figures well-supported by academic research.⁹² Further, using
15 historical GDP growth as the long-term growth figure is a reasonable proxy by which to estimate
16 long-term growth rate for a utility such as UNS Electric.⁹³

17 Further, Mr. Rigsby is the only witness to rely on the CAPM method – without adjusting
18 the market risk premium to produce a reasonable and realistic result. UNS Electric described the
19 significant problems with Mr. Rigsby's CAPM method in its Initial Post-Hearing Brief.⁹⁴ The fact
20 remains that Mr. Rigsby's CAPM results are below the Company's cost of debt, which is an
21 illogical result.⁹⁵

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24 ⁸⁸ Ex. UNSE-24 (Pritz Rejoinder) at 2.

25 ⁸⁹ See Ex. UNSE-34 (Parcell APS Excerpt).

26 ⁹⁰ Ex. UNSE-23 (Pritz Rebuttal) at 18.

27 ⁹¹ Ex. UNSE-23 (Pritz Rebuttal) at 4.

⁹² Ex. UNSE-23 (Pritz Rebuttal) at 4-5.

⁹³ Ex. UNSE-22 (Pritz Direct) at 10; Ex. UNSE-23 (Pritz Rebuttal) at 5.

⁹⁴ UNS Electric Initial Post-Hearing Br. at 37.

⁹⁵ Ex. UNSE-24 (Pritz Rejoinder) at 4.

1 In short, the evidence is that RUCO's recommended ROE of 9.25% is below any
2 reasonable level of ROE authorized for an electric or gas utility.

3 **VI. FINANCIAL INTEGRITY.**

4 Throughout this case, Staff and RUCO have provided no evidence to justify that their
5 respective ROE and revenue requirements recommendations would allow the Company an
6 opportunity to earn a reasonable return. And their opening briefs do not address the issue.
7 However, even Mr. Parcell acknowledged during the hearing that a sufficient level of earnings was
8 necessary to maintain the Company's financial integrity and that "sufficient level of earnings"
9 includes the opportunity to earn its authorized return on equity.⁹⁶

10 As the Company has shown through its forecasts prepared by financial professionals, UNS
11 Electric is likely to only earn an ROE of 7.9% under Staff's revenue requirements
12 recommendations, and only 6.0% under RUCO's revenue requirement recommendations.⁹⁷ Under
13 either party's recommendation, UNS Electric has *no* opportunity to earn its authorized ROEs.

14 Nor do Staff and RUCO provide any analysis as to whether UNS Electric would maintain
15 its investment grade rating by Moody's of Baa3 (the lowest investment grade rating). Yet there is
16 no doubt investors pay close attention to actual report financial results. If this credit rating were
17 lowered, then it would adversely impact UNS Electric's ability to refinance debt, or secure
18 financing, on reasonable terms. A lower credit rating means UNS Electric would be subject to
19 higher interest rates. Those increased costs would ultimately be born by the ratepayers. To ignore
20 the adverse consequences of Staff and RUCO recommendations would lead to long-term negative
21 impacts to both the Company and its customers. Such a result is not in the public interest.

22 **VII. FAIR VALUE.**

23 In its Direct Filing, UNS Electric proposed a fair value rate of return ("FVROR") of 6.88%.
24 The Company based its FVROR recommendation upon the method approved in the Chaparral City
25 Remand Order – Decision No. 70441 (July 28, 2008). It very well could have justified a FVROR

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27 ⁹⁶ Tr. (Parcell) at 803.

⁹⁷ Ex. UNSE-13 (Grant Rebuttal) at 22-26.

1 of 8.08% because that is the value determined using the method the Commission approved in the
2 Chaparral City Remand Order – Decision No. 70441.⁹⁸ Or it could have justified a FVROR of
3 7.99% based on the method the Commission approved in the Chaparral City 2009 Rate Case –
4 Decision No. 71308 (October 21, 2009).⁹⁹ However, in its Application, it recommended neither,
5 because a FVROR of 6.88% would allow a reasonable opportunity for it earn its authorized ROE
6 given the other appropriate adjustments proposed by the Company. In short, the Company
7 balanced its need for a reasonable opportunity to earn its ROE with minimizing the impact to
8 customers.

9 Unfortunately, neither Staff nor RUCO in this case support the methods adopted in those
10 decisions – although neither party denies the reasonableness of the methods adopted by the
11 Commission in those decisions. The problems with Staff and RUCO methods in this case are
12 detailed in the Company’s Initial Post-Hearing Brief.¹⁰⁰

13 **A. Response to Staff.**

14 Staff supports a method in this case that was not adopted in either Decision Nos. 70441 or
15 71308. In fact, Staff supported the method ultimately adopted in Decision No. 71308 in the
16 Chaparral City’s 2009 rate case. It is puzzling why Staff witness Mr. Parcell supports methods
17 that: (i) are mathematically equivalent to the discredited “backing in” method (his primary
18 method); and (ii) have been rejected in past orders (his alternate proposal). Staff’s brief provides
19 little, if any, justification as to why Mr. Parcell’s methods is reasonable and should be used instead
20 of the methods approved in Decision Nos. 70441 and 71308.¹⁰¹

21 In this case, Mr. Parcell also adjusted his method so that “fair value” of his debt and equity
22 components equals 5.49%. That is well below the cost of capital even if the full rate of inflation is
23 subtracted from Staff’s weighted average cost of capital (8.40% minus 2.0% or 6.40%).¹⁰² As a
24 result, Staff’s alternate proposal is unsupported by the evidence in the record. Further, 5.49%

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26 ⁹⁸ Ex. UNSE-12 (Grant Direct) at 14.

27 ⁹⁹ Ex. UNSE-12 (Grant Direct) at 14.

¹⁰⁰ See UNS Electric Initial Post-Hearing Br. at 45-49.

¹⁰¹ Staff’s Opening Br. at 22.

¹⁰² See Ex. Staff-14 (Parcell Direct) at 56, Ex. DCP-1 (Schedule 1)

1 FVROR on debt and equity is equivalent to the “backing in” method the Arizona Court of Appeals
2 rejected.¹⁰³ Therefore, Staff’s method in this case is unlawful in addition to being unsupported by
3 the evidence.

4 **B. Response to RUCO.**

5 RUCO advocates for a method that overstates the impact of inflation. Further, in the
6 Chaparral City 2009 Rate Case, RUCO supported the method adopted in Decision No. 70441 (the
7 Chaparral City Remand Order). In Decision No. 70441, the Commission subtracted the full rate of
8 inflation only from the cost of equity. The Commission rejected the method RUCO now
9 advocates here to calculate FVROR, which proposes to subtract the full rate of inflation from both
10 the cost of debt and cost of equity.¹⁰⁴ The problem with the method RUCO now advocates here is
11 that FVRB is one-half original cost. Original cost is stated in original nominal dollar terms and is
12 not impacted by inflation.¹⁰⁵ By subtracting the full rate of inflation from both the cost of debt and
13 cost of equity, RUCO’s method essentially double-counts the impact of inflation. The impact of
14 inflation was more appropriately applied in the Chaparral City 2009 Rate Case (Decision No.
15 71308) – where the Commission used an inflation component adjusted by one-half.¹⁰⁶

16 RUCO argues that because RCND has “a tendency to grow faster than the rate of inflation”
17 the entire inflation rate should be subtracted from both debt and equity.¹⁰⁷ This argument is
18 without merit. RUCO witness Dr. Johnson provides no evidence that reproduction costs grow
19 faster than the rate of inflation.¹⁰⁸ To the contrary, UNS Electric witness Mr. Grant provides
20 evidence that plant replacement costs have grown at a rate that is only slightly higher than the

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22 ¹⁰³ Ex. UNSE-14 (Grant Rejoinder) at 5.

23 ¹⁰⁴ Decision No. 70441 at 34-38.

24 ¹⁰⁵ Ex. UNSE-13 (Grant Rebuttal) at 16. See also Decision No. 71308 at 43-44 (stating that “Because on
25 half of the FVRB includes OCRB, which does not include inflation, Staff adjusted the 2.4 percent
26 inflation factor by one-half, resulting in an inflation adjustment to the [weighted average cost of capital]
27 of 1.2 percent.”)

¹⁰⁶ See Decision No. 71308 at 43-44, 49 (stating that “Staff’s Method 2 appropriately matches an inflation-
free rate of return to FVRB. The Method 2 recommendation of Staff to apply an inflation adjustment to
both the equity and debt components of the [weighted average cost of capital] is a reasoned and sound
approach to determining a FVROR that equitably balances the needs of the Company and its ratepayers
and results in the setting of just and reasonable rates.”)

¹⁰⁷ RUCO’s Initial Closing Brief at 21.

¹⁰⁸ Ex. UNSE-13 (Grant Rebuttal) at 17.

1 overall rate of inflation.¹⁰⁹ In addition, even Dr. Johnson admits that OCRB is given half weight
2 in developing FVRB and OCRB does not increase with inflation.¹¹⁰ Dr. Johnson also provides no
3 studies or analyses supporting his assertion that technological changes or economies of scale have
4 any significant impact on the replacement costs. The fact remains that the Commission's method
5 of determining FVRB is comprised of one-half OCRB and one-half RCND. No party proposes to
6 change that method to determine FVRB. Since one-half of FVRB is not impacted by inflation, it is
7 unreasonable to subtract the entire rate of inflation from COC to determine the FVROR on FVRB.
8 The Commission appropriately weighted the impact of inflation in Decision Nos. 70441 and
9 71308. By contrast, RUCO's theory is unreasonable, unconstitutional and unsupported in the
10 record.

11 **C. FVROR for BMGS.**

12 UNS Electric proposes to apply the weighted average cost of capital only to the FVRB of
13 BMGS. This is because the OCRB and FVRB for BMGS are very similar.¹¹¹ The concerns about
14 inflation do not apply to BMGS because the facility was only put into commercial operation on
15 June 1, 2008 and the OCRB for BMGS reflects its value as of December 31, 2008.¹¹² Further,
16 applying the weighted average cost of capital to BMGS provides the Company with no "windfall
17 profit." To the contrary, it merely provides UNS Electric the ability to adequately service the debt
18 and equity costs for BMGS that UNS Electric must raise to finance the acquisition.¹¹³ A
19 FVROR recommended by Staff or RUCO would not support the acquisition of BMGS.

20 **D. Conclusion on FVROR.**

21 Staff and RUCO propose FVROR values of 6.01% and 5.96% respectively. Those are
22 insufficient, inadequate and unreasonable values. The Company carefully determined a FVROR
23 of 6.88% which would be the *minimum* value necessary to give it a reasonable opportunity earn its
24 authorized ROE – provided that its revenue requirement recommendations were adopted. If its

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26 ¹⁰⁹ Ex. UNSE-14 (Grant Rejoinder) at 7-8.

¹¹⁰ Ex. RUCO-8 (Johnson Surrebuttal) at 4.

¹¹¹ See UNS Electric Initial Post-Hearing Brief at 49.

¹¹² Tr. (Grant) at 245-46.

¹¹³ Ex. UNSE-12 (Grant Direct) at 15-16; Tr. (Grant) at 224.

1 revenue requirement proposed in its Application is not adopted, then the Company recommends
2 (in the alternative) that a FVROR be determined by either the method approved in Decision No.
3 70441 or Decision No. 71308. Both methods are reasonable means to determine FVROR. Staff
4 and RUCO propose radical methods that give no weight to the fair value of debt and equity and
5 overstate the effects of inflation. The Commission should not adopt the unreasonable methods
6 advocated by Staff and RUCO.

7 **VIII. RATE DESIGN.**

8 **A. Monthly Customer Charge.**

9 UNS Electric's rate design proposal encourages and promotes conservation and combines
10 those goals with a reasonable opportunity to recover its revenue requirement. The proposed
11 modest increase to monthly customer charges is a vital part of that design. UNS Electric proposes
12 to increase the residential monthly customer charge by 50 cents – from \$7.50 to \$8.00. Staff
13 supports the modest increase. But RUCO proposes a radical change to rate design that would de-
14 stabilize revenue recovery and divorces the Company's need for revenue stability from
15 conservation and energy efficiency.

16 RUCO witness Dr. Johnson bases his residential monthly charge recommendation of \$5.00
17 on marginal cost principles. A \$5.00 residential customer charge, however, would not even cover
18 fixed costs of metering, meter-reading, billing and customer service and understates costs of items
19 typically classified as customer-related.¹¹⁴ These are charges the Company incurs regardless of the
20 demand customers place on UNS Electric's system or the energy customers use.¹¹⁵ Dr. Johnson
21 suggests that the Commission should deviate from average embedded cost principles that have
22 been accepted for over two decades.¹¹⁶ However, Dr. Johnson knows of no case where the
23 Commission has adopted his radical and unprecedented rate design.¹¹⁷

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26 ¹¹⁴ Ex. UNSE-19 (Erdwurm Rebuttal) at 5.

27 ¹¹⁵ Ex. UNSE-19 (Erdwurm Rebuttal) at 5.

¹¹⁶ Ex. UNSE-20 (Erdwurm Rejoinder) at 5.

¹¹⁷ Ex. UNSE-29 (RUCO response to UNSE 2.10).

1 The Company proposes a modest increase for all customer classes to gradually move
2 toward cost of service – while also preserving the inverted block design established in its last rate
3 case. Dr. Johnson’s rate design will drive UNS Electric’s need to recover its revenues through
4 increased volumetric sales of electricity and away from conservation.¹¹⁸ The Company’s proposal
5 is a balance and reasoned approach, while RUCO supports extreme measures based on
6 questionable principles and arguments.

7 Regarding RUCO’s arguments that costs allocated to the customer should only include
8 variable costs of metering, billing, and collecting the monthly bill,¹¹⁹ RUCO ignores the fact that
9 UNS Electric must incur costs to bill customers and that these costs do not vary with energy
10 sales.¹²⁰

11 RUCO also argues that “setting customer charges at relatively high levels encourages kWh
12 consumption and discourages energy conservation – both of which are contrary to the public
13 interest and good public policy.”¹²¹ The Company strongly disagrees. First, the monthly customer
14 charges proposed are below the cost of service.¹²² Second, the Company’s proposal is a “step
15 towards providing more incentive for encouraging energy efficiency programs because the revenue
16 requirement is less dependent on customers consuming electricity.”¹²³ Third, Dr. Johnson’s rate
17 design “will drive UNS Electric’s need to recover its revenues towards increasing use of power
18 and away from conservation.”¹²⁴ UNS Electric’s witness D. Bentley Erdwurm showed how Dr.
19 Johnson’s proposal puts UNS Electric’s revenue stability at greater risk.¹²⁵ Obviously, without
20 recovering sufficient revenues, the Company will not have funds to invest in additional energy
21 efficiency and conservation measures. This is why Dr. Johnson’s rate design would create a
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23 ¹¹⁸ Ex. UNSE-19 (Erdwurm Rebuttal) at 8.

24 ¹¹⁹ RUCO Initial Closing Br. at 18-19.

25 ¹²⁰ Ex. UNSE-20 (Erdwurm Rejoinder) at 2-3.

26 ¹²¹ RUCO Initial Closing Br. at 19.

27 ¹²² See Ex. UNSE-18 (Erdwurm Direct) at 20 (stating that the Company “is asking to increase the monthly
customer charges to levels *closer* to the cost-based levels indicated in the Class Cost of Service Study”
[emphasis added]).

¹²³ Ex. UNSE-18 (Erdwurm Direct) at 20.

¹²⁴ Ex. UNSE-19 (Erdwurm Rebuttal) at 8.

¹²⁵ See Ex. UNSE-20 (Erdwurm Rejoinder) at 5-6, Exhibit DBE-6.

1 significant disincentive for the Company to aggressively pursue creative and effective conservation
2 programs.¹²⁶

3 Finally, RUCO also argues that the Company's proposal to increase the monthly customer
4 charge is not based upon a valid economic analysis.¹²⁷ This is not accurate. In fact, the economic
5 analysis (average embedded costs) has been used by the Commission for over 20 years to justify
6 electric company rate proposals.¹²⁸ Further, several other jurisdictions are moving in the opposite
7 direction from Dr. Johnson's proposal in this case.¹²⁹ The Commission should adopt UNS
8 Electric's rate design because it properly balances all of the important factors when designing rates
9 while aligning the Company's need for revenue recovery with conservation and energy efficiency
10 goals.

11 **B. "Super-Peak" Rate Option.**

12 UNS Electric proposes the "super-peak" option as part of its plan to expand TOU options
13 for customers and make TOU plans more attractive to customers. The "super-peak" option does
14 not foreclose development of a real-time pricing plan as part of a future demand-side management
15 ("DSM") portfolio. But the "super-peak" option is easy to implement and easy for customers to
16 understand.¹³⁰ Further, while a real-time option would take considerable time to develop, the
17 "super-peak" option can be implemented now. The Commission should approve this rate option
18 as part of the Company's expanding-TOU options for its residential customers and general service
19 customers under 3 megawatts ("MW").

20 **IX. CARES AND LOW-INCOME ISSUES.**

21 The Company's proposed treatment for CARES customers would result in an average
22 decrease of 9.41% to their bills.¹³¹ In its last rate case, the Commission approved the Company's
23 current CARES rate structure because "CARES customers receive progressively lower discounts

24 ¹²⁶ Ex. UNSE-19 (Erdwurm Rebuttal) at 8.

25 ¹²⁷ RUCO Initial Closing Br. at 18.

26 ¹²⁸ Ex. UNSE-20 (Erdwurm Rejoinder) at 3, 5.

27 ¹²⁹ Ex. UNSE-20 (Erdwurm Rejoinder) at 4.

¹³⁰ Ex. UNSE-19 (Erdwurm Rebuttal) at 17.

¹³¹ Ex. UNSE-18 (Erdwurm Direct) at 28 and Exhibit DBE-2, page 2, line 18; Ex. UNSE-19 (Erdwurm Rebuttal) at 11.

1 on their bills, thereby providing customers with a price signal that encourages such customers to
2 limit their energy use.”¹³² While RUCO argues that this may be unnecessarily complicated, all
3 UNS Electric proposes in this case is to: (i) lower the monthly customer charge to \$3.50; (ii)
4 reduce the base power supply rate; (iii) freeze the PPFAC rate at zero; and (iv) maintain the
5 additional percentage discounts the Commission approved in Decision No. 70360. Unlike
6 RUCO’s proposal, UNS Electric provides specifics about how CARES customers can be held
7 harmless.¹³³ In short, UNS Electric’s proposal maintains the structure the Commission approved in
8 the Company’s last rate case while holding CARES customers harmless.

9 Staff agrees with the Company’s CARES proposal – except it continues to urge
10 asymmetrical treatment for CARES customers regarding the PPFAC that would be detrimental to
11 non-CARES customers. In short, Staff’s proposal that CARES customers be subject to PPFAC
12 rate decreases, but not increases, is unreasonable. As stated in its Initial Post-Hearing Brief, UNS
13 Electric’s other customers would bear the burden with none of the reward.¹³⁴ The impact of
14 Staff’s proposal on the Company is also uncertain.¹³⁵ For these reasons, Staff’s proposal regarding
15 the PPFAC rate and CARES customer is inequitable and should be rejected. Maintaining the
16 PPFAC rate for CARES customers at zero (with all of the other discounts in base rates CARES
17 customers will receive) more than adequately holds these customers harmless.

18 **X. PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE.**

19 The Company originally sought only two changes to its PPFAC, both of which were
20 opposed by Staff. The first change was to apply the appropriate interest rate to under- and over-
21 recoveries of fuel and purchased power costs. The current applicable carrying cost (*i.e.*, the one-
22 year Nominal U.S. Treasury Constant Maturities rate) does not accurately reflect the interest rate
23 UNS Electric actually incurs when it must borrow from its joint credit facility. Further, keeping
24 the current carrying cost does not provide any more or less incentive to try to achieve the best and
25

26 ¹³² See Decision No. 70360 (May 27, 2008) at 55.

27 ¹³³ See Ex. UNSE-18 (Erdwurm Direct) at Exhibit DBE-2a.

¹³⁴ See UNS Electric Initial Post-Hearing Brief at 55-56.

¹³⁵ Tr. (Stewart) at 505.

1 most stable costs for its customers. This is evidenced by the fact that the PPFAC rate decreased
2 starting April 1, 2009 – leading to an average savings of over 20% on the average residential
3 customer bill. This savings would have been greater if the LIBOR plus 1.0% had been in effect.
4 The Company maintains its proposal to approve use of the 3-month LIBOR rate plus 1.0% - re-set
5 on a monthly basis.

6 For the same reasons, RUCO's recommendation for a 90/10 sharing mechanism is
7 unnecessary and unfair. The Commission rejected this proposal in UNS Electric's last rate case.
8 A sharing mechanism is unnecessary because the evidence shows the Company's current
9 procurement policies did result in a substantial decrease in fuel and purchased power costs. If the
10 90/10 sharing mechanism were in effect, customers would not have received as substantial a
11 decrease. RUCO also does not provide any material justification for implementing a 90/10 sharing
12 now. Although RUCO asserts that UNS Electric previously had relied only on a full requirements
13 contract with APS, the prior rate case was decided with full knowledge that the new PPFAC would
14 apply when that APS contract expired.

15 Finally, the Company proposed to recover credit support costs through the PPFAC. Upon
16 reviewing Staff's recommendation the Company proposed, in the alternative, proposed to recover
17 \$195,500 in base rates (as explained in Section IV, Subsection I). The Company finds either option
18 acceptable.¹³⁶ But there is no doubt these are legitimate and necessary costs to finance under-
19 collections of fuel and purchased power.¹³⁷ And the evidence is clear that these costs are not
20 already being recovered because it was not included in the cost of debt.¹³⁸

21 **XI. MISCELLANEOUS ISSUES.**

22 UNS Electric maintains its position on all miscellaneous issues for the reasons stated in its
23 Initial Post-Hearing Brief.¹³⁹
24
25

26 ¹³⁶ See Ex. UNSE-23 (Grant Rebuttal) at 26; Tr. (Grant) at 201.

27 ¹³⁷ Ex. UNSE-12 (Grant Direct) at 22 and Exhibit KCG-4.

¹³⁸ See UNS Electric Initial Post-Hearing Br. at 58.

¹³⁹ See UNS Electric Initial Post-Hearing Br. at 61-66.

1 UNS Electric has agreed to all of Staff's recommendations regarding changes to its rules
2 and regulations.¹⁴⁰

3 The Company opposes Staff's recommendations to list worst performing circuits due to the
4 added expense and because it would effectively duplicate the Company's current reliability
5 monitoring and ignores other important reliability considerations.¹⁴¹ Staff's testimony regarding
6 audits does not identify specific issues or problems and is vague; therefore, Staff's position should
7 be rejected.¹⁴² Further, while the Company does not oppose thermal scanning, it should be
8 allowed to determine the appropriate timing of the thermal scans consistent with sound operational
9 practices.¹⁴³

10 **XII. CONCLUSION.**

11 UNS Electric respectfully requests that the Commission issue a final order:

- 12 (1) granting the Company the permanent rate increase sought herein;
- 13 (2) approving the new or modified rate and service schedules with an effective date no
14 later than June 1, 2010;
- 15 (3) approving the proposed rate design;
- 16 (4) authorizing UNS Electric's depreciation rate update;
- 17 (5) approving UNS Electric's revised Rules and Regulations;
- 18 (6) approving the requested modifications to the PPFAC effective as of June 1, 2010;
- 19 (7) approving UNS Electric's proposed rate base adjustment and rate reclassification
20 with respect to the proposed acquisition of the Black Mountain Generating Station;
- 21 (8) approving the proposed Renewable Generation Ownership Plan; and
- 22 (9) granting the Company such additional relief as the Commission deems just and
23 proper.

26 ¹⁴⁰ UNS Electric Initial Post-Hearing Br. at 61-62.

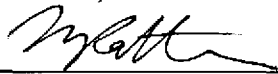
27 ¹⁴¹ UNS Electric Initial Post-Hearing Br. at 62-63.

27 ¹⁴² UNS Electric Initial Post-Hearing Br. at 65.

27 ¹⁴³ UNS Electric Initial Post-Hearing Br. at 63.

1 RESPECTFULLY SUBMITTED this 2nd day of April 2010.

2
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